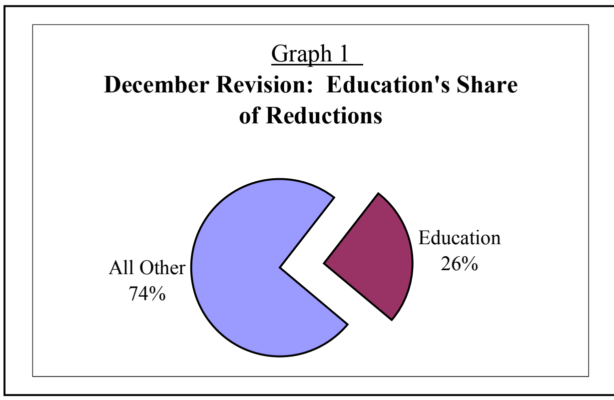
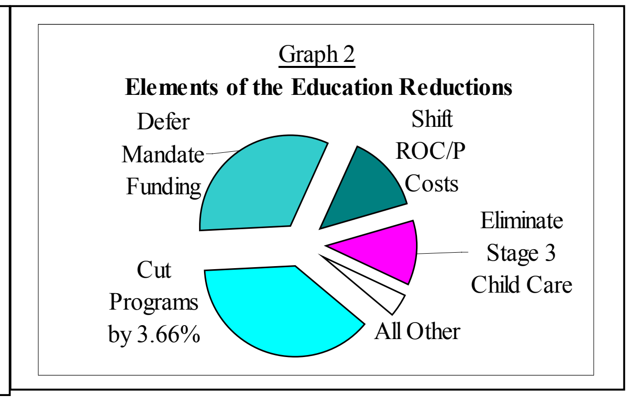
K-12 Education

K-12 EDUCATION

The December Revision reduces General Fund support for K-12 Education by $2.6 billion, 26 percent of the total proposed reductions. Graph 1 illustrates the point.





The largest share of this reduction is associated with an across-the-board cut to all programs, for a savings of nearly $1 billion. By deferring reimbursement for school mandates, General Fund costs would temporarily fall by nearly $900 million. The Administration also proposes to "free up" $350 million in the Proposition 98 funding by reverting appropriations from prior fiscal years and using these funds to Regional Occupational Program ("ROC/P") costs in the current year. By eliminating Stage 3 Child Care, the General Fund saves nearly $300 million in the period ending June 30, 2004. Graph 2 details the relative share of these elements of the revision.

Below, staff provide background on Proposition 98, specifics on the reductions contained in the December Revision, and an alternative way of making the reductions, as suggested by the Legislative Analyst.

BACKGROUND

Proposition 98. Under Proposition 98 the state is required to maintain state appropriations and local property tax funding adjusting for Average Daily Attendance (ADA) growth and cost-of-living from year to year. When State General Fund revenue growth (per capita) is equal to, or exceeds the growth in Per Capita Personal Income (PCPI) the guarantee is said to be based on "Test 2" and PCPI is used as the Proposition 98 COLA. When the reverse is true and the difference is greater than a half percent, then Per Capita GF Revenue growth may be used in lieu of PCPI, and the guarantee is said to be based on "Test 3".

To the extent that the state takes advantage of "Test 3" it is constitutionally required to rebuild the Proposition 98 base back to the level that it would have been using PCPI as the inflator. The amount that must be restored is called the "maintenance factor" and it is equal to the difference between the Test 2 level and the amount actually appropriated below that level in a Test 3 year. It is not the difference between tests 2 and 3, thus providing an incentive not to build the "maintenance factor" any more than necessary. A maintenance factor is also created if Proposition 98 is suspended. A constitutional formula, based on the degree to which General Fund per-capita revenue growth exceeds personal income growth, determines how much maintenance factor must be restored in any one year. The amount is roughly equal to half the revenue growth, until the guarantee is fully restored.

Last year was a Test 3 year. In 2001-02, the State could have appropriated $9.4 billion less that the Test 2 level. Instead, the State only took advantage of $3.9 billion of the $9.4 and ended the year owing a $3.9 billion Proposition 98 maintenance factor. The 2002-03 Budget Act was scheduled to restore $3.2 billion of the maintenance factor, and the budget trailer bill (Sec. 54 of AB 2781 of 2002) promised restoration of the remaining $700 million in the 2003-04 year.

With the failure of state revenues to meet expectations, the Department of Finance and Legislative Analyst both believe that the maintenance factor restoration requirement has been reduced in the current year (2002-03) by $1.9 billion. Since the Governor already vetoed $143 million of budget act appropriations, the state may reduce another $1.7 billion of current year appropriations, and still meet the required Constitutional restoration requirement.

If $1.7 billion is reverted, the State will have still restored $1.3 billion of maintenance factor in the current year ($3.2 - $1.9 = $1.3). The State will then be obligated, under the trailer bill promise, to restore both the original balance of $700 million, and the $1.9 billion, in 2003-2004. What part of this $2.6 billion would be constitutionally required to be restored is not yet known.

Implications and Alternatives. Because the $1.9 billion results from reduction in this year's obligation to restore the maintenance factor, reducing Proposition 98 appropriations does not make a permanent reduction in the Proposition 98 base. The $1.9 billion will still have to be restored in the future, just not this year. It is possible that the entire $1.9 billion will have to be restored in 2003-04, along with the remaining $700 million, although this cannot be predicted without revised estimates of revenue, population, personal income and enrollment that should accompany the Governor's Budget in January.

Since revenues are so far down this year, next year's revenues are almost certain to "grow" by comparison, and thereby trigger maintenance factor restoration. If the Constitution does not require full restoration, Section 54 of AB 2781 should be repealed to allow the State to take advantage of declines in the revenues or other factors that could reduce the Proposition 98 guarantee. If this still does not offer enough flexibility, the Proposition 98 guarantee may be suspended by 2/3 vote in a bill separate from the Budget Act.

Suspension, although almost unprecedented[1], may be preferred by some education interest groups as an alternative to manipulations of the guarantee that place non-educational programs under the guarantee in an attempt to meet the constitutional requirement. At present, the Education Coalition led by the CTA remains adamantly opposed to suspension.

Timing. It is obvious that the sooner school districts know what to expect, the better they can adjust. Also, real cuts need more advanced notice than deferrals that pay for this year's programs with next year's money. On a technical basis however, the $1.7 billion needs only to be reverted before the end of the fiscal year. There is nothing in the proposed mid-year K-12 cuts that legally must be done by January 30.

[1] Suspension authority was invoked once before to block any education claims on sales tax proceeds dedicated to Loma Prieta earthquake relief.

ACROSS-THE-BOARD CUTS

The Governor proposes to reclaim $1 billion of the $1.7 billion appropriated above the current year minimum with an "across-the-board" cut of 3.66%. The first thing to understand about this is that the proposal is actually a 2.15% cut to school district revenue limits and an approximately 3.66% cut to categorical programs.

School districts funding is primarily unrestricted revenue limit funding that is comprised of both local property tax and state unrestricted general fund allocation. District revenue limits were created to equalize school funding per pupil, so each district's revenue limit is made up of different proportions of state and local funds. The infamous "basic aid" districts are those with so much property tax that they only receive the $120 per pupil constitutionally mandated "basic aid." Basic aid districts currently get to keep their excess property tax revenue, so a reduction of their revenue limits has no actual impact on their available funding.

Implications and Alternatives. The Department of Finance only applied the 3.66% cut to the state aid part of statewide total of revenue limit funding, thereby proposing to cut combined state and local revenue limit funding by 2.15%. A Department of Finance representative says that the difference was intentional "so that districts would have more flexibility with their unrestricted funding." The result however is to cut categorical programs (including special education and compensatory education) by 1.51% more than general-purpose revenue limits. Since large urban districts tend to receive more of their funding from categorical sources, they would also be disproportionately affected by reducing categoricals more that the revenue limits.

To yield the same dollar amount from a true (undifferentiated) across-the-board cut would require a cut of approximately 2.5%. If an across-the-board cut is accepted, perhaps as part of the solution, then Senate Education Committee staff recommends that it be an undifferentiated percentage of whatever percent is necessary to meet the dollar target.

The Education Coalition is opposed to any across-the-board cuts and coalition has promised to develop a list of programs that could be targeted for reduction or elimination in lieu of overall reductions. The coalition also argues that it is too late for any cuts this year since payroll and benefits make up 85% of typical district budgets. Instead of outright cuts, the Coalition urges that funding be deferred and the programs paid for by 2003-04 appropriations, as was done last year. The

Legislative Analyst has also developed a list of targeted program funding that could either by cut or deferred.

Paying It Back. During the fiscal crisis of the early nineties, the state suspended all Cost-of-living Adjustments (COLA) for K-12 schools, but did so by preserving the statutory entitlement and offsetting it with a negative statutory adjustment that had to be renewed each year. This both preserved the schools right to receive inflation adjustment when the crisis was over (the resultant "deficit" was bought out over a period of years) and gave the legislature some bargaining leverage since the deficit statute had to be renewed annually and any veto made the entire deficit due and payable immediately.

The across-the-board cut is proposed as a permanent reduction even though it amounts to a negative COLA that could be cast as a deficit adjustment, as was done before. The Education Coalition, which opposes across-the-board cuts, will still ask for a deficit statute if such a reduction is part of the final decision.

Budget Control Language. Most of the K-12 education budget items are proposed to be amended to include the following language:

"The amount of funds in this item reflects an approximate 3.66 percent across-the-board reduction to all Local Educational Agencies receiving funds from this item. Notwithstanding any other provision of law, the Superintendent of Public Instruction shall reduce every allocation by a proportionate amount to effect this reduction."

Aside from the propriety of attempting to override substantive law with budget language, this language gives the Superintendent of Public Instruction no latitude to do obviously reasonable things, such as realize savings by first offsetting cuts against surplus funding before making uniform "across-the-board" reductions. Staff recommends either no language or the following substitute:

"*This item has been reduced with the intent that grants and other allocations made from this appropriation should be proportionately reduced. The Superintendent of Public Instruction and Controller are requested to effectuate this intent to the extent practical and necessary in order to maintain programs within available funding."*

Mandated Cost Control. The proposed cuts shave 3.66% off of each of the scheduled reimbursement allowances. Mandates are not like grants where the amount paid out is discretionary on the part of the state. The claims are what they are, once audited and approved, the state must eventually pay the full claim. We can pay 96.44% of each claim, and still owe 3.66%, or we can achieve permanent savings in a less cumbersome manner. Alternative ways of accomplishing this savings would involve deferring one or more claims (100%) until a future year, or repealing one or more mandates, or a combination that defers the current payable and repeals the mandate for the future. Partial payment of actual seems like the least logical option.

The administration proposes to defer payment of $870 million in state mandate claims that count towards Proposition 98. This includes $259 million in claims for the School Bus Safety II mandate, which was recently shown in a state audit to contain non-reimbursable costs. Some or all of these costs will eventually need to be paid, but there is no urgency to pay them this year. The state does pay interest on overdue claims at the Pooled Money Investment Account rate.

Special Education: Risk of Violating Federal Maintenance of Effort Requirement. Special education (for the handicapped) is treated like all other programs in that state funding is proposed to be cut by 3.66% ($99 million). Unlike most other programs, Special Education is partially federally funded and we risk the loss of over $800 million of federal funds if we violate their "maintenance of effort" requirements. In the current year, the budget already uses a $133 million federal increase to pay for a cost of living adjustment that would otherwise be a General Fund obligation. Reduction of State Funding by the $99 million is likely to violate the maintenance of effort requirement.

We don't know, at this point, how much Special Education can be reduced without violating the maintenance of effort requirement. If Special Education is to be included in cuts at all, the MOE requirement should be recognized with a cap on the reduction. Congressman George Miler is aware of this issue and is likely to seek federal budget language that would strengthen the MOE language, perhaps prohibiting the supplanting of the $133 million, as well as the $99 million cut.

REVERSION ACCOUNT "SWAP"

The administration proposes to "free up" $350 million in current year Proposition 98 funding (which then can be used for non-Prop. 98 purposes) by reverting appropriations from prior fiscal years and using these funds to pay for $350 million in Regional Occupational Program (ROC/P) costs in the current year. The ROC/P appropriation was chosen because it is large enough to offset the whole $350 million, and not for any policy reason. This is similar to the "adult education swap" done in last year's budget.

The funds proposed for reversion (and then "swapping") represent savings, not program reductions. However, some of the savings come from funding which the Legislature used to pay for Stage 3 childcare services in the current year budget. If the Legislature rejects the Governor's proposal to eliminate Stage 3 child care, approximately $57.5 million of the total proposed for reversion will not be available for this "swap," and further reductions or savings would be necessary. On the other hand, if the Legislature chooses to follow the Legislative Analyst's proposal to pay for Stage 3 child care in part with one-time federal funds, no additional Prop. 98 reversions would be necessary.

CATEGORICAL PROGRAM "FLEXIBILITY"

The Administration proposes to assist school districts to adjust to proposed mid-year cuts by allowing districts the flexibility of reducing traditional categorical program funding by as much as 20% and transferring the funds to (but not from) any of four programs: Special Education, K-3 Class Size Reduction, Child Nutrition (School Lunch & Breakfast) and Supplemental Instruction (Summer school, after school, etc.)

This type of categorical flexibility has been made available for many years through the so-called "mega-item" language, but the four mentioned programs have never been on the mega-item list. Various surveys have shown that the existing language is primarily used to convert categorical funding to general purpose funding by transferring funds to a program like home-to-school transportation and buying out the local general fund share (encroachment) of program costs. This frees-up the local general purpose funding.

The administration's proposed "flexibility" seems designed to encourage more fund conversion since each of the named programs has substantial local encroachment that could be bought out. It is not clear how this proposal helps a local district cope with cuts but it may encourage categorical funding reductions in excess of the proposed 3.66%.

CATEGORICAL PROGRAM SAVINGS

The administration proposes a number of reductions to categorical program appropriations in order to capture anticipated savings. On the whole, there does not appear to be any programmatic impact to these reductions. The Department of Education concurs that savings exist in all of these appropriations but one: the California Information Technology Academies program (a $2.4 million difference in estimated savings). This action does not need to be taken by January 30th.

The Department of Education has also assembled a list of additional savings. Many of these are included in the Legislative Analyst's alternative proposal (see below). The Department would also favor some flexibility to move small amounts of funding between programs should some of the estimated savings not materialize.

LAO PROPOSAL

The Legislative Analyst argues that across-the-board cuts would have an adverse impact on direct services to students and would be difficult for school districts to absorb in the remaining months of the fiscal year. The Analyst proposes targeting reductions at programs that do not have a direct influence on student services.

The Analyst's alternative proposal includes 1) targeted reductions, 2) additional reversions, 3) a funding shift for Stage 3 childcare (to federal savings), and 4) deferrals. Their proposal would result in over $500 million in additional general-purpose funds.

The LAO alternative is shown on the next page. *Those items which would likely not be supported by the Legislature are shown in italics.*

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Program	Description of Alternative	Savings (in millions)
Instructional Materials – one time grants	Delay requirement that districts purchase new instructional materials. Many districts have recently purchased materials under the AB 2519 process.	$150.0
Reduce revenue limit COLA from 2% to 1.66%	In the current year the Legislature provided a "super COLA" of 2 percent, though the statute only called for a 1.66 percent COLA. The provision of law which allows for mid-year layoffs if the state provides a COLA lower than 2 percent was suspended for 2002-03 in last year's trailer bill. If this were presented as part of a substitute for an across the board cut (of a higher percentage), it is not clear how the Legislature would respond.	95.5
Reduce categorical COLA from 2% percent to 1.66%	(see above)	25.4
Backfill Stage 3 child care with one-time federal funds	This is an option that should be strongly considered. If federal funds are not used, the Legislature will have to find $79 million in additional Prop. 98 savings to pay for Stage 3. This appears to be a partial backfill – the total required is $99 million.	79.1
Supplemental instruction	Revert unused portion of funds from this program from prior fiscal year (1998).	69.9
High Priority Schools Grant Program	*Eliminate second cohort for this program. In addition, use budget year funds to pay for the final current year payment, since the final payment will not be paid to schools until the budget year. Note: Elimination of the second cohort will be a problem, but the deferral of the final payment may not.*	*66.2*
Immediate Intervention/Under-performing Schools	Use budget year funds to make final current year payment since the final payment (20%) will not be paid to schools until September, 2003.	39.6
Math & Reading Professional Development	Delay initiation of this program until future years. This is a Governor's priority.	63.4
School Library Materials	Temporarily suspend program	32.7
Community College Part-Time Faculty	*Cut part-time faculty extra compensation (as of February 1, 2003)*	*24.0*
Miscellaneous	Enact a combination of various reductions & reversions	115.5
Deferrals	Provide funding for programs administered in 2002-03 in July 2003. This proposal is similar to the deferrals done in last year's budget process. Deferring additional funding would put some pressure on the budget year, but would have little current year programmatic impact.	317.0

Total		**$1,078.4**